

# Australia: 2015 and beyond

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## AAAC Outlook Day

Perth - November 2014

Stephen Koukoulas  
Market Economics

 @thekouk

# The world economy – fair to middling

- The pick up in global growth after the GFC is losing traction – not badly, but it is noticeable
- While Australia's major trading partners are doing better than the rest of the world, growth is only about 4% which is less than the 5% that was common before the GFC



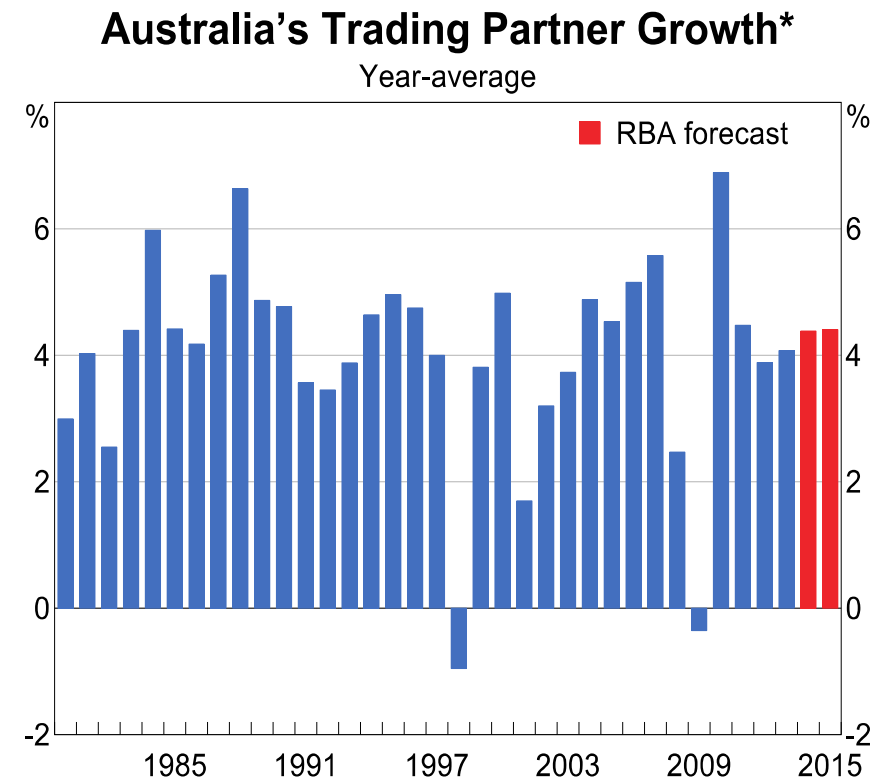
\* Weighted using Australian export shares

\*\* PPP-weighted; accounts for 87 per cent of world GDP

Sources: ABS; CEIC Data; IMF; RBA; Thomson Reuters

# The outlook: Again – not bad, not great

- The Reserve Bank is forecasting economic growth in our trading partners to be around 4.25% in 2015
- Central banks around the world are still primed for growth, even if there is some scaling back of the super-easy policy settings
- This *should* be good news as it supports Australian export growth



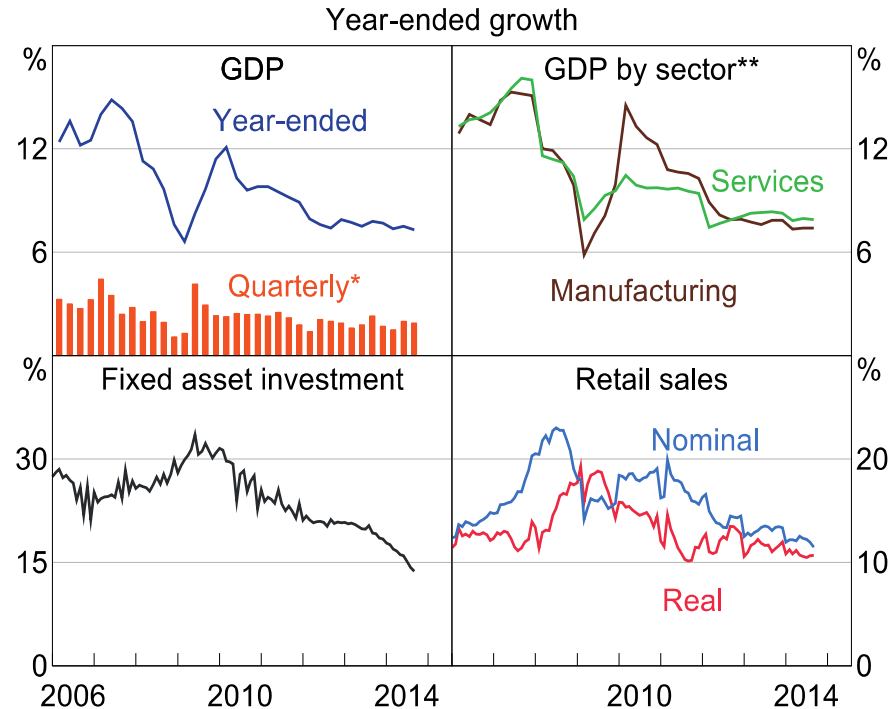
\* Aggregated using total export shares

Sources: ABS; CEIC Data; RBA; Thomson Reuters

# The incredible Chinese economy... slowing?

- A well known story of the past 20 years is the strength of the Chinese economy
- There is clear evidence of less rapid growth, but the economy is still strong
- For the moment, the slow down is manageable – but any slower and the whole world will get worried

## China – Activity Indicators



\* RBA estimates prior to the December quarter 2010

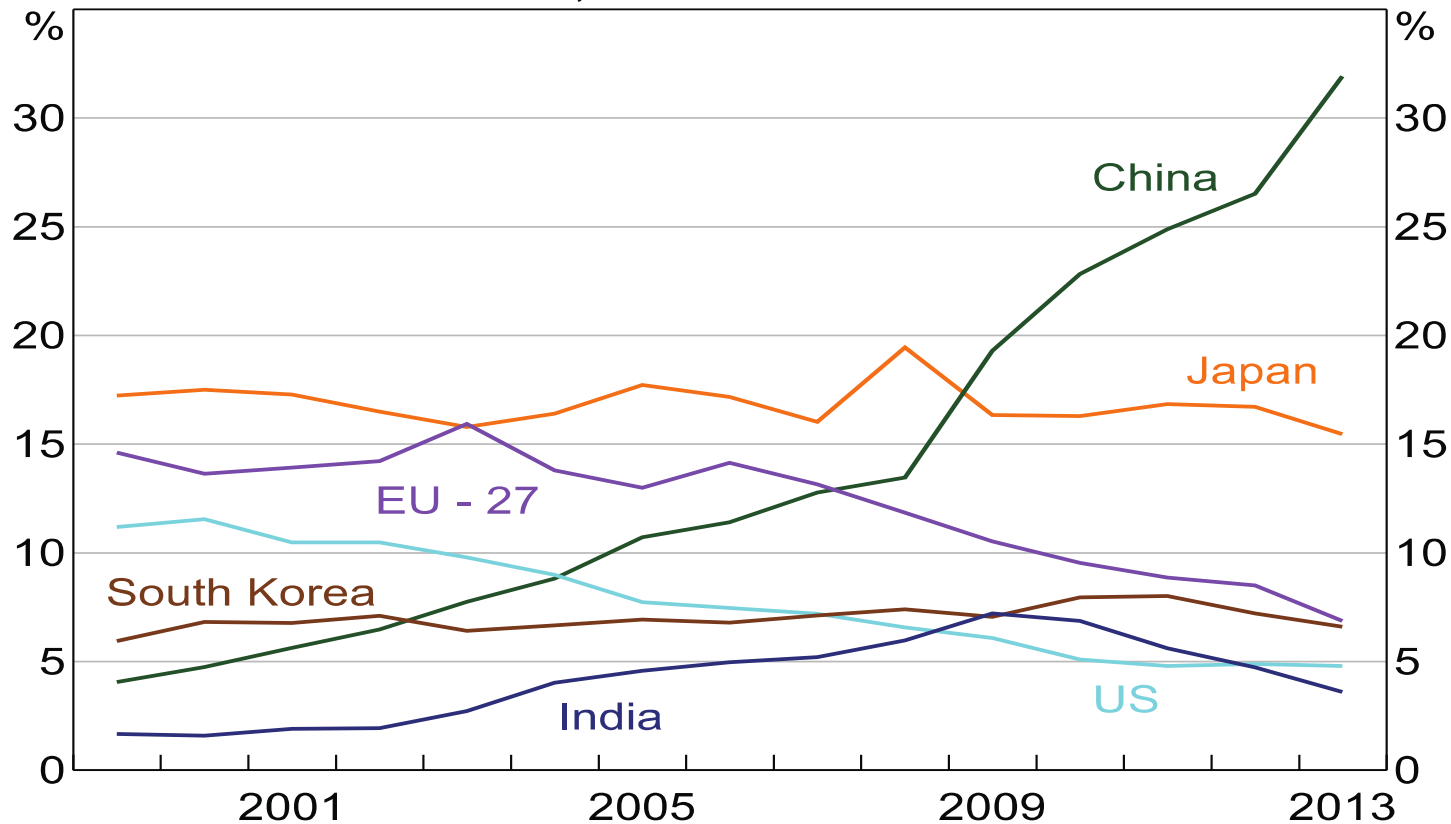
\*\* Year-to-date; manufacturing and services sectors refer to secondary and tertiary gross value added

Sources: CEIC Data; RBA

# Australia's future - China (and Asia)

## Exports by Destination

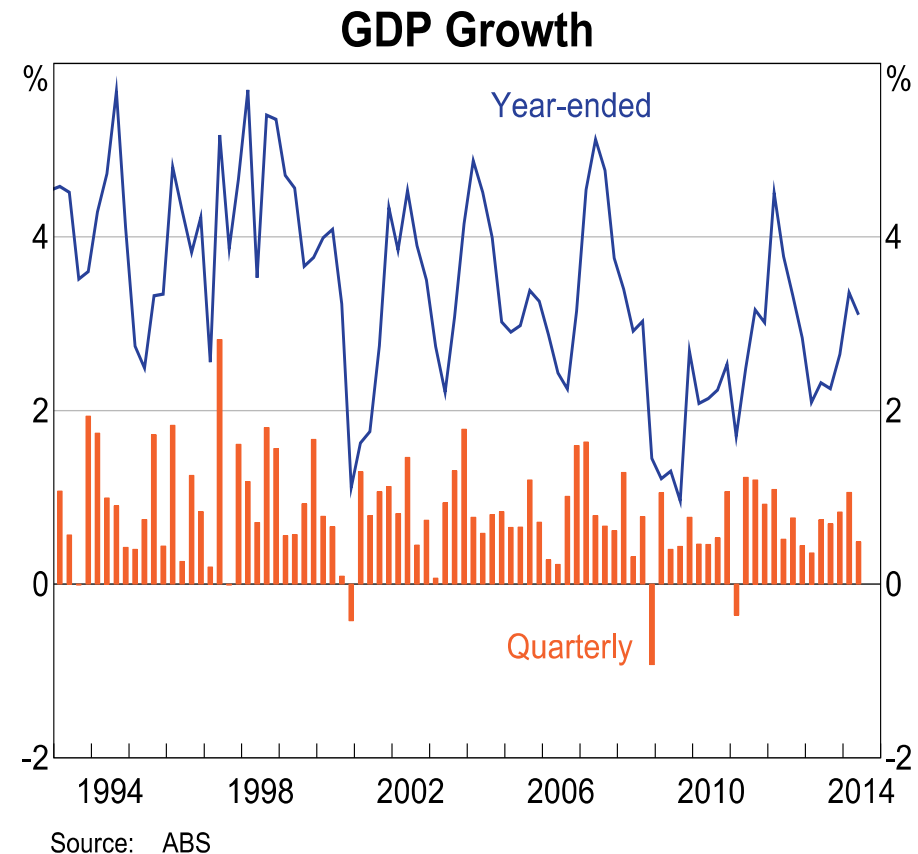
Annual, share of total values



Source: ABS

# Australia – Still growing but starting to cool?

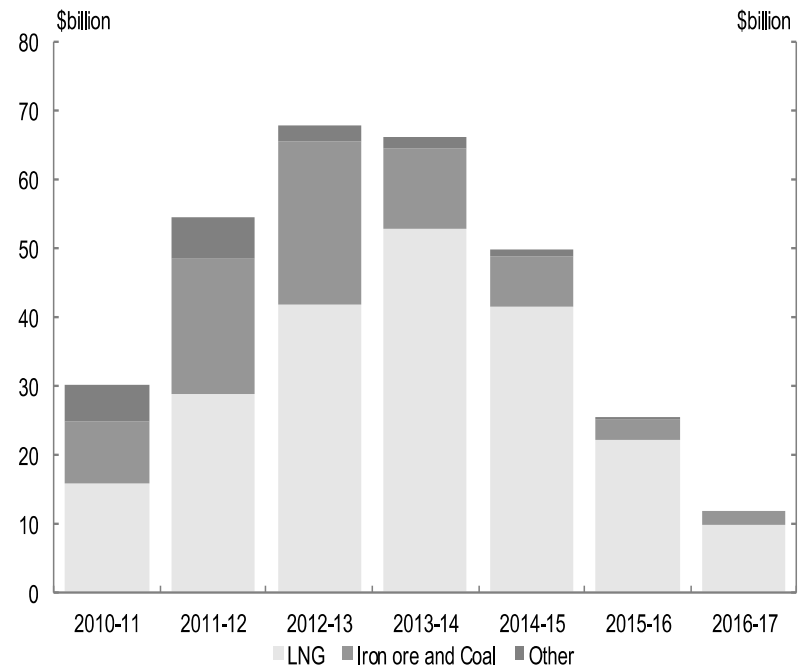
- The economy has done well so far in 2014
- Real GDP growth is around 3% but is expected to slow
- The RBA is forecasting GDP growth to be around 2.5% in 2015, which for some parts of the economy will feel very weak



# A challenge – mining investment collapses

- The key point of the economic outlook is the fall away in mining investment
- ...from around \$70 billion a year in 2013-14 down to just above \$10 billion within three years
- Will other sectors provide the offset to keep the economy on an even keel?

Chart 4: Spending on major resources projects

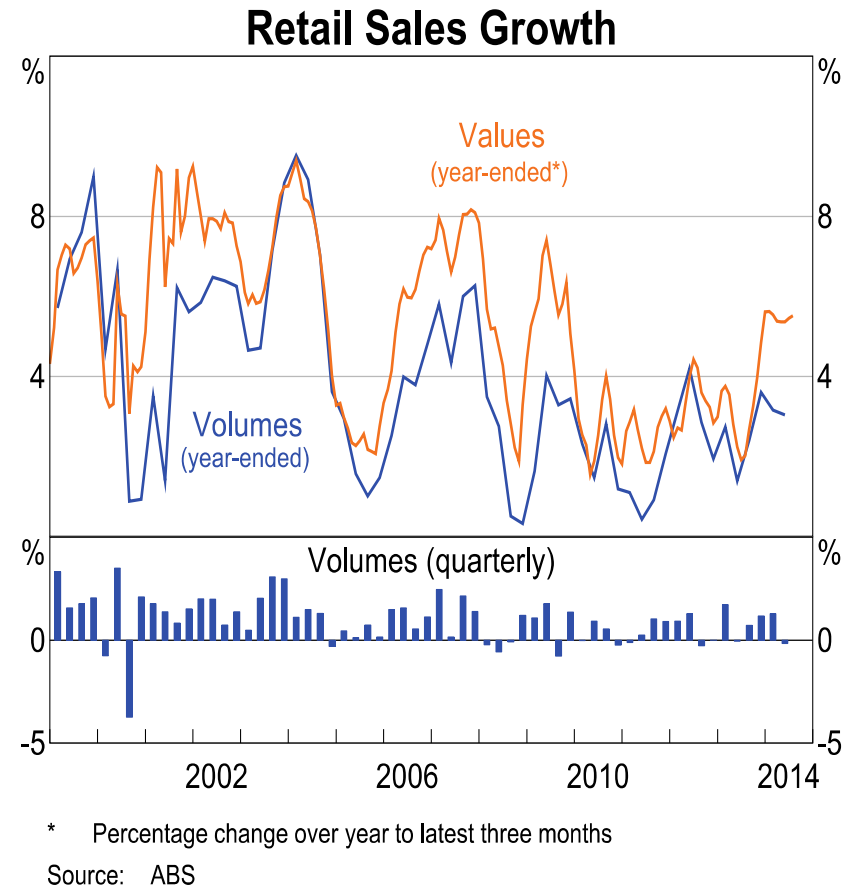


Note: Treasury's major resources projects profile is the sum of spending on existing and planned resources projects greater than \$2 billion, weighted by their probability of going ahead.

Source: Treasury.

# Retail spending is solid

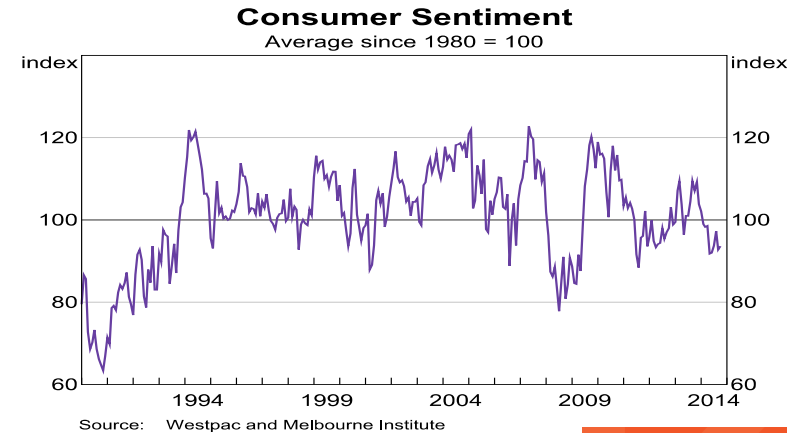
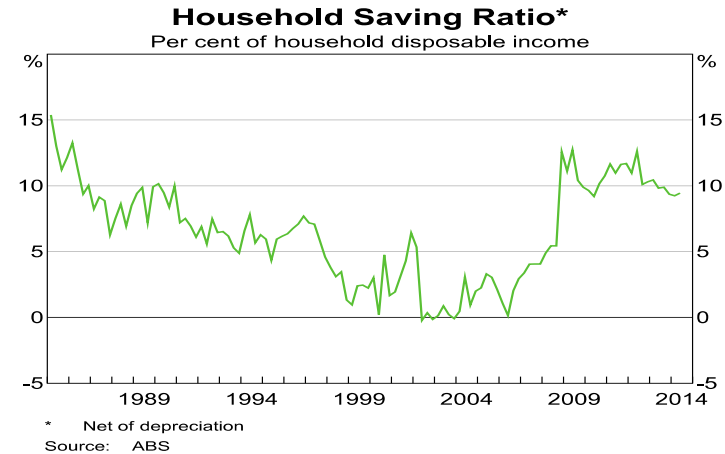
- Consumers were cautious after GFC, they had a lot of debt and low savings
- After the 2013 election, consumer spending picked up nicely, with growth moving to a trend pace
- ...but since the Budget, spending has slowed as consumers react to fear of spending cuts and tax hikes





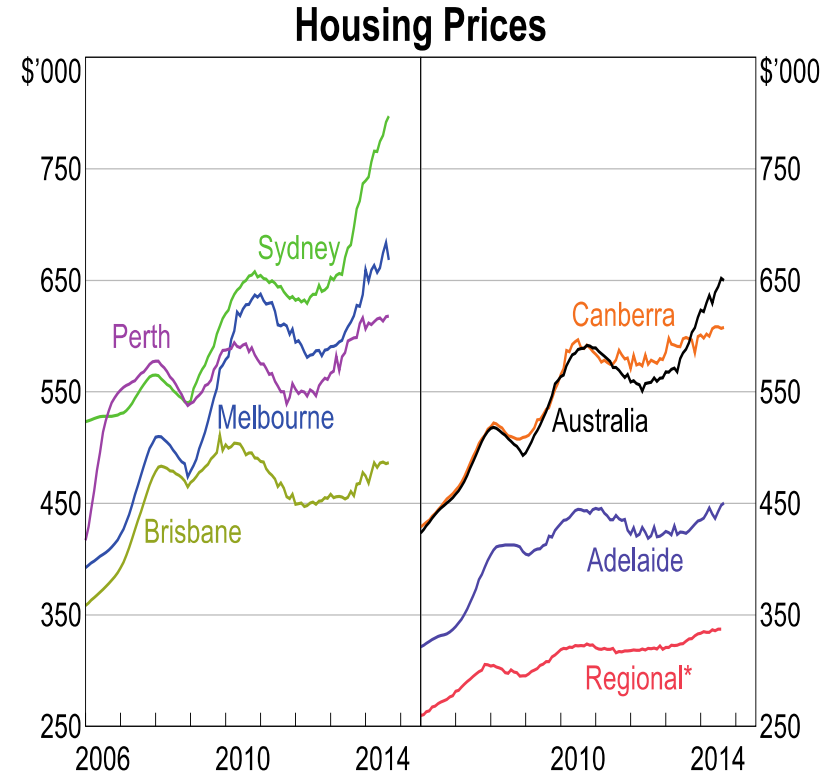
# Consumers – cashed up but sentiment falling

- Consumers are now saving 10% of their incomes – this help explains the soft period for retail spending
- But... it means they have cash to spend when conditions are 'right'
- Consumer sentiment did pick up after election, but has since been crunched and it remains low



# Rising house prices – just Sydney & Melbourne?

- House prices are marching higher, but the gains are concentrated in Sydney & Melbourne
- Other cities house prices are little changed from levels around 2009 and 2010
- RBA wants house price growth to slow but is not sure how to do it – not interest rate increases, but more likely other restrictions

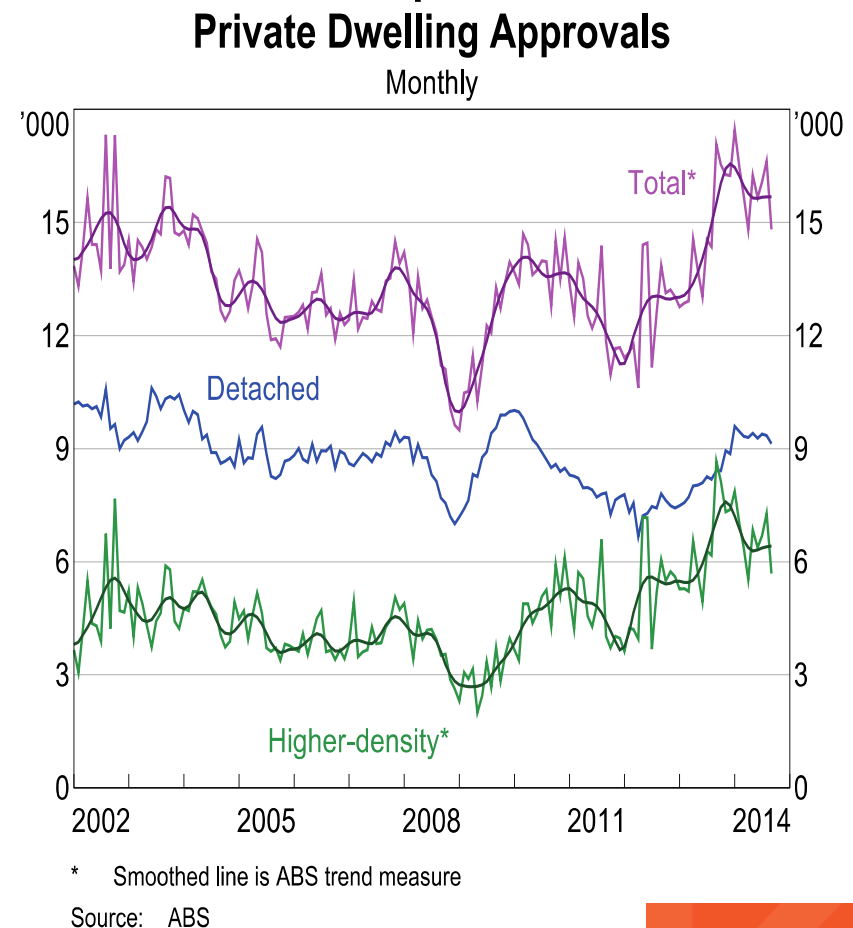


\* Excludes apartments; measured as areas outside of capital cities in mainland states

Sources: RBA; RP Data-Rismark

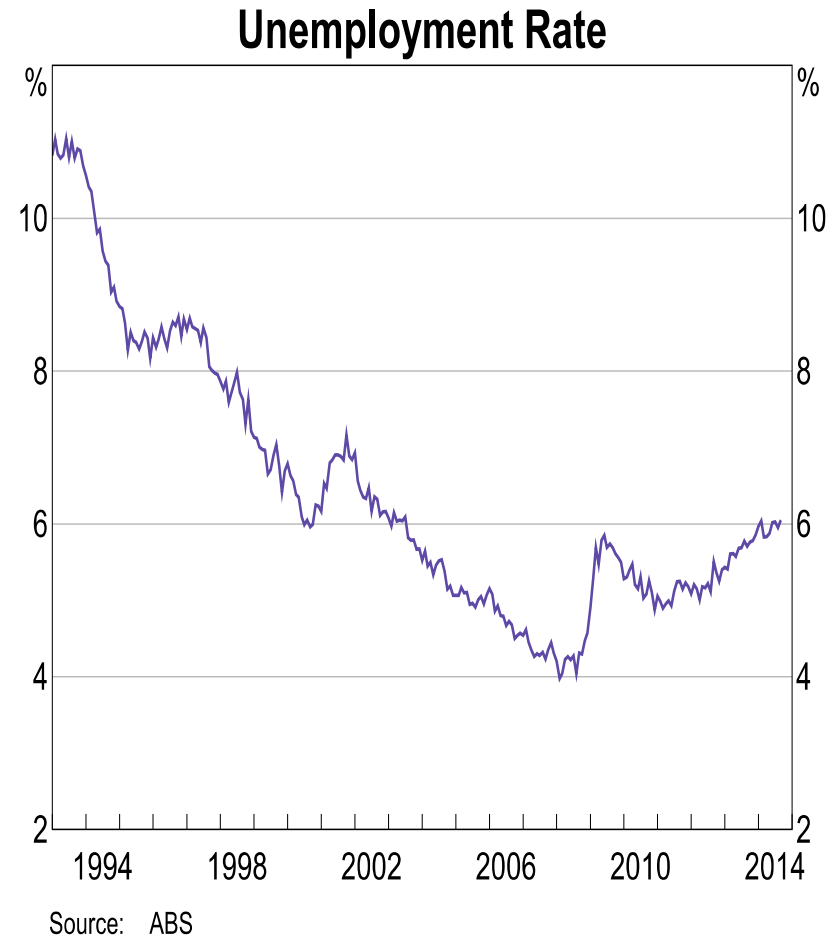
# Is housing construction edging lower?

- Until about 6 months ago, housing construction was booming which was seeing a lift in housing supply
- Much of the lift is in high density dwellings which reflects affordability and the desire of many to live in inner city apartments
- In recent months, the uptrend has been reversed – a blip or something more worrying



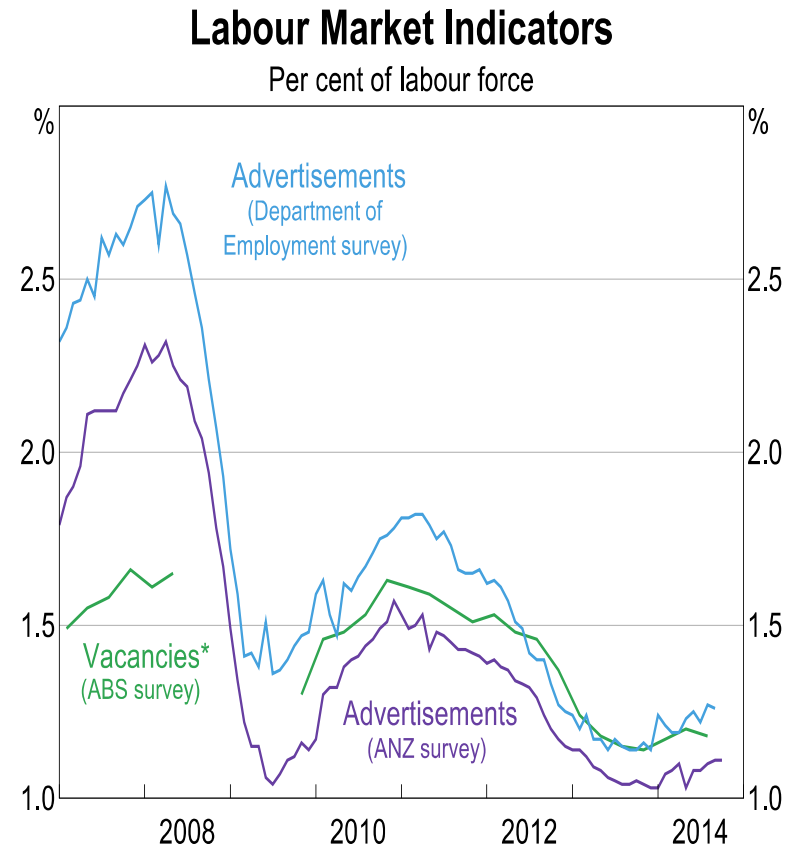
# Unemployment rate at a 12 year high

- The poison for housing and consumers with high debt levels is unemployment
  - It is very difficult to make repayments when you don't have a job
- The rise in unemployment is getting to a point of some concern - need a stronger economy to not only stem the rise but to get unemployment back down



# Is the outlook for jobs turning up?

- The rise in unemployment *may* be nearing an end – some of the leading indicators for job creation have turned higher
- That said, the rise is very tepid – another 12 months of strong increases in job ads is needed before we can be sure unemployment will head lower

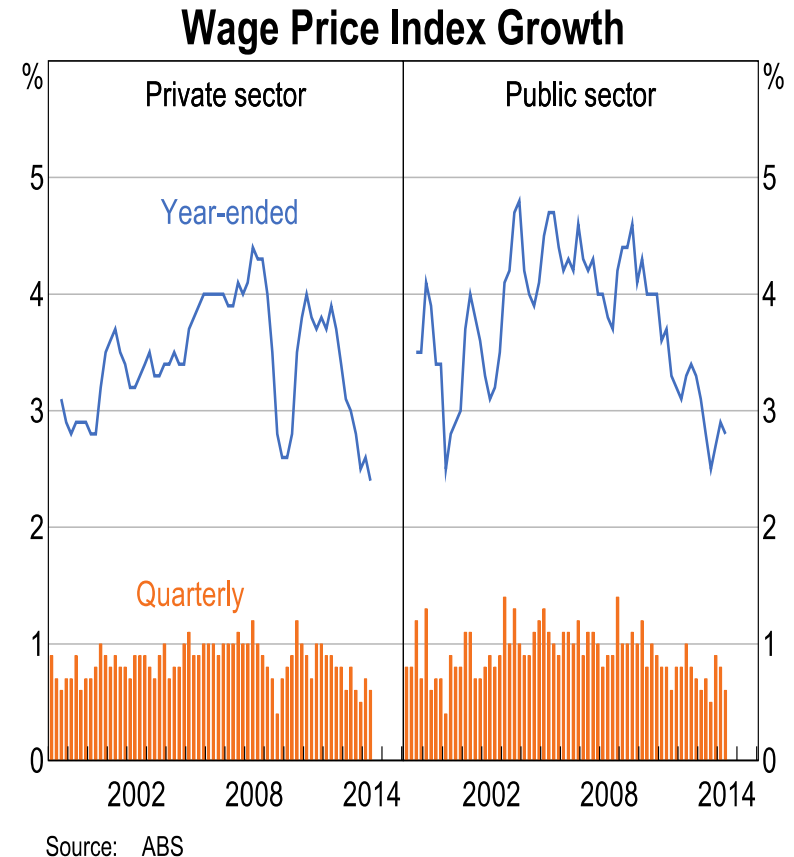


\* This survey was suspended between May 2008 and November 2009

Sources: ABS; ANZ; Department of Employment

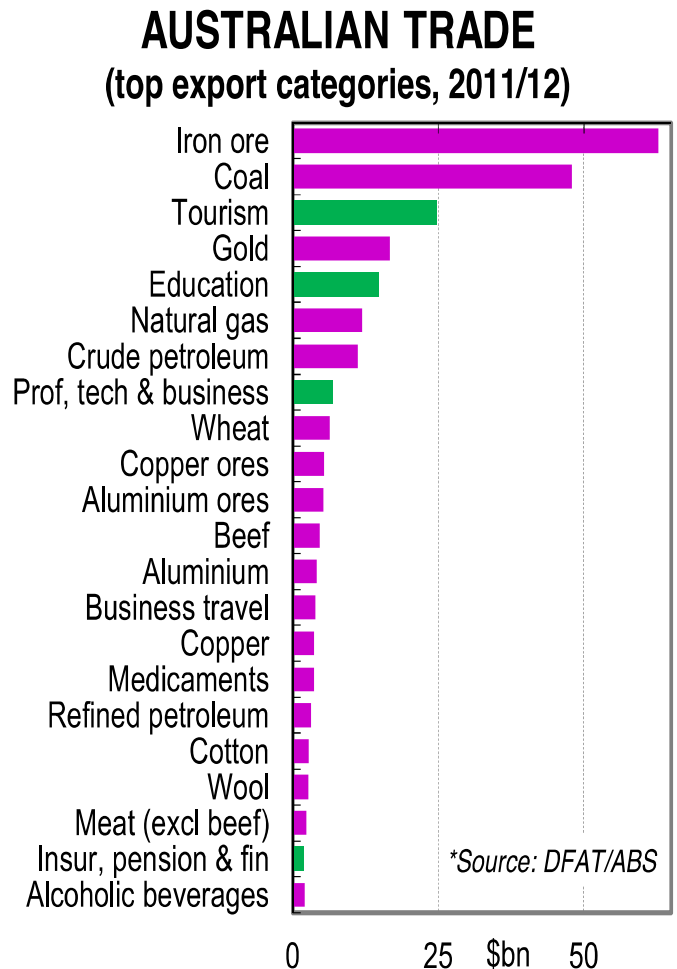
# Weak wages growth – an economic risk

- Wages growth is running at a record low
- Bad: It dampens household incomes, spending power & borrowing
- It is a risk to the economic outlook
- But it has an upside – employer demand for labour remains firm so it helps job creation



# Australia's Top 20 Exports

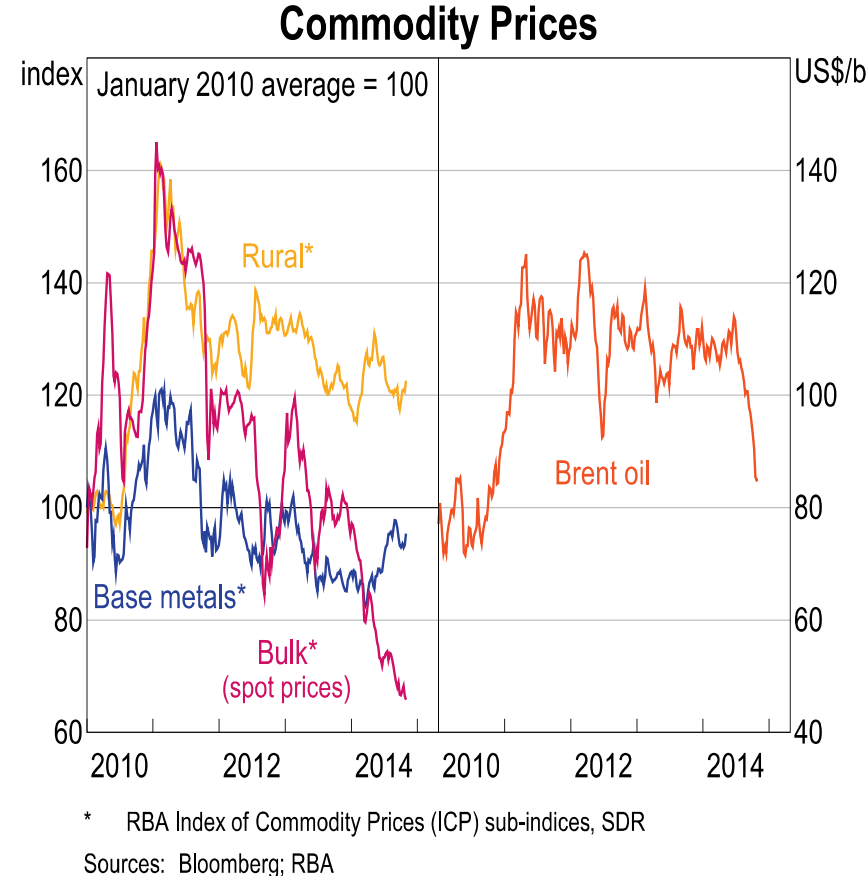
- There has been massive growth in exports of iron ore and coal for more than a decade
- Services exports are trending higher with tourism and education now important sources of export dollars
- Rural exports have been rising solidly, in line with the rise in output – wheat, beef, cotton and wool the main items



Source: CBA

# Rural prices holding up - other prices free-fall

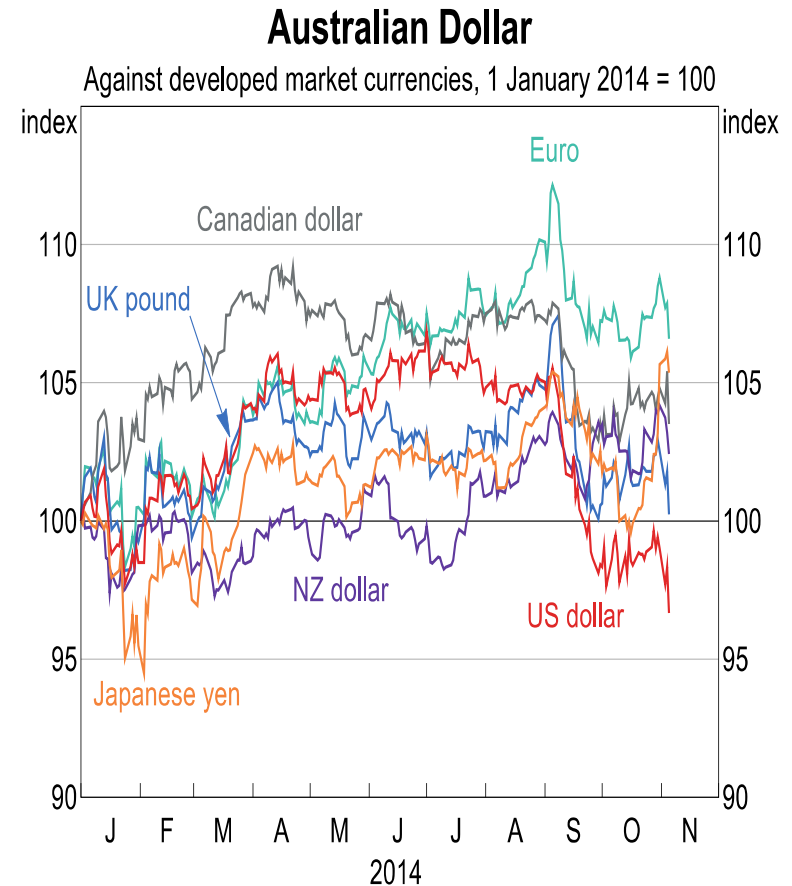
- A lot of focus recently has been on the slump in iron ore, coal, oil and gold prices
- Amid that storm, rural prices have been holding up well, especially with the Aussie dollar a little weaker
- As Aussie dollar falls further, in wake of general price falls, rural prices should be supported





# The Aussie dollar – heading lower (sort of)

- Since the start of 2014, the Aussie dollar has generally been stronger against most currencies – the recent exception in the US dollar
- This is despite the economy growing less rapidly, commodity prices falling and interest rates remaining low
- It should fall further, but needs a circuit breaker (higher US interest rates or lower Aussie interest rates) to move it



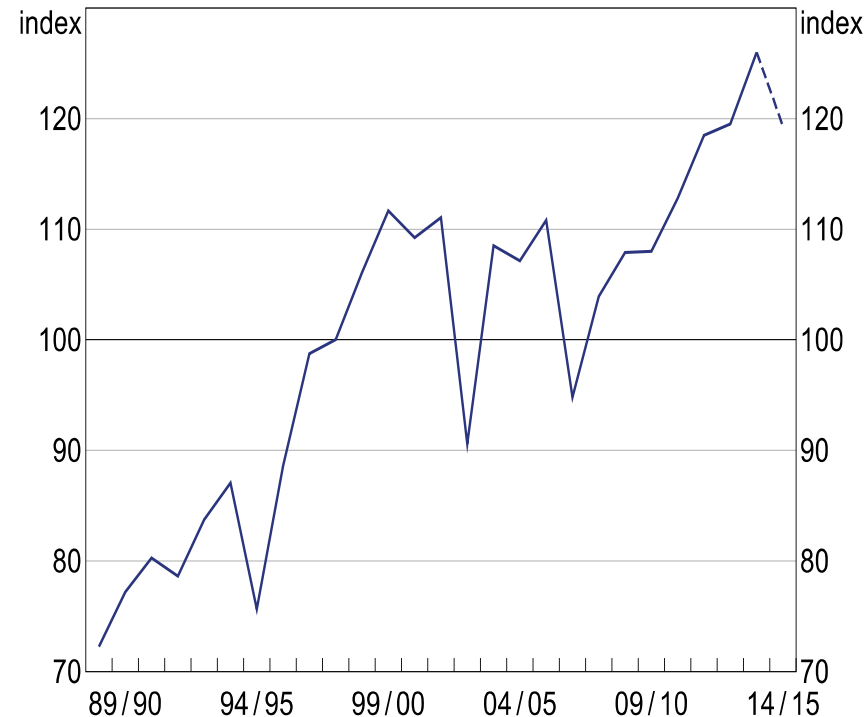
Source: Bloomberg

# Farm output has been strong

- There was a decade from the late 1990s to late 2000s where farm output was broadly flat – climate, commodity prices were a hindrance
- Over the past few years, output has risen 25% on the back of more favourable weather, technology

## Volume of Farm Production\*

1997/98 = 100

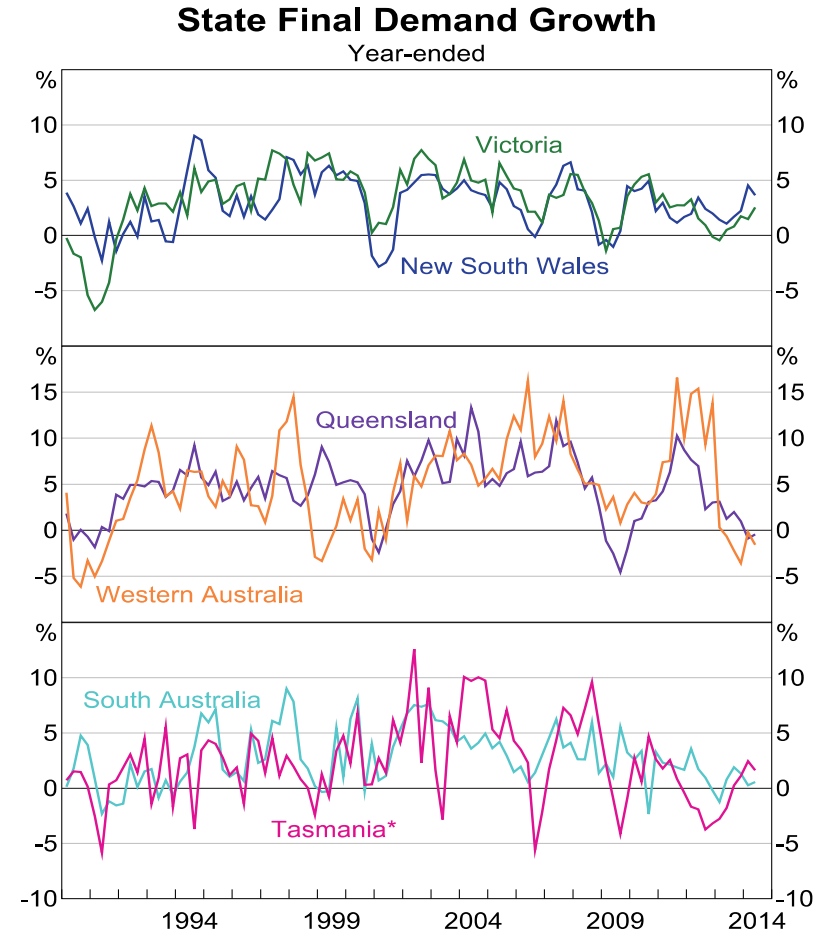


\* The solid line represents ABARES' estimate while the dotted line represents ABARES' 2014/15 forecasts

Source: ABARES

# State demand – mining downturn evident

- WA and QLD are slowing at an alarming pace – the mining investment fall is impacting
- SA and TAS were the weakest but there are some tentative signs of a turn, especially in TAS
- NSW and VIC still expanding at a decent pace – less volatile than the other states

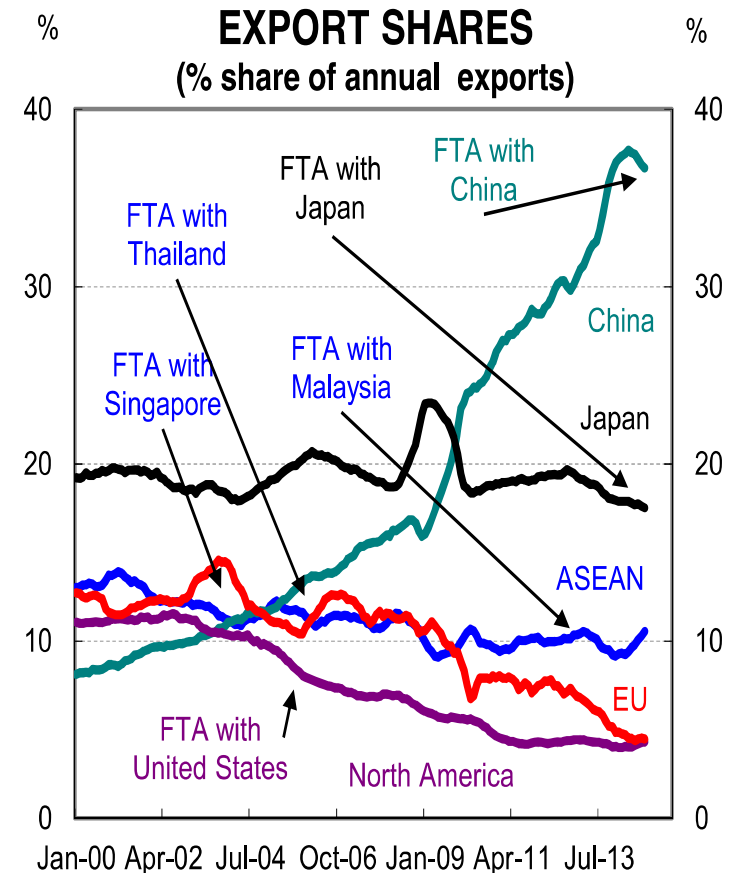


\* Adjusted for the purchase and sale of ferries in 2002

Sources: ABS; RBA

# Free trade agreements... Mixed success

- Over the past decade, Australia has entered into a range of FTAs
- While useful, they have not obviously seen a surge in trade with the country/region involved
- Indeed, the export share of countries/regions we have FTAs with have tended to fall



Source: CBA

# The FTA with China – an Agriculture focus

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Dairy	All tariffs of up to 20% will be removed in four to eleven years
Beef	Tariffs ranging from 12-25% will be removed over nine years
Sheep and goat meat	23% tariff phased out over eight years
Barley and sorghum	Immediate removal of 3% tariff on barley and a 2% tariff on sorghum
Live bovine exports	5% tariffs phased out over four years
Skins, hides and leather	Two-to-seven-year phasing out of up to 14 per cent in tariffs
Wine	Removal of all tariffs, ranging from 14-20%, over four years
Coal	Removal of 3% tariff on coking coal and 6% tariff on thermal coal from the start of the agreement
Aluminium oxide	8% tariff will be removed from day one.
Financial services	Agreement to create RMB clearing bank in Sydney
Lawyers	Can form associations with Chinese firms in Shanghai
Tourism	Can build, operate and renovate hotels in China
Labour mobility	More flexible rules for projects over \$150m
Investment	More access to Chinese investment in Australia

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*Source: AFR, CBA*

# What's ahead - The big issues and risks

- Economy, overall, is reasonable, but is set to slow: Inflation to fall so interest rates on hold... for now, but likely cut later
  - House price growth may moderate
  - Confidence has been shot by the budget, with risk to spending
- Other risks are mainly overseas
  - China slowdown?
  - US monetary policy tightening?
  - Eurozone implodes?

# The forecasts

- GDP growth at less than 3% in 2015
- Job creation to remain sluggish into 2015; unemployment rate 6.25% or higher a while longer
- Inflation set to ease – nearer 2% in 2015
- The RBA on hold – an interest cut more likely than a hike as the next move
- Australian dollar – set to fall, but for now it remains resilient. No surprise if it falls below US\$0.80